DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 98-0338
INDIANA FINANACIAL INSTITUTIONS TAX
For Years 1993, 1994, 1995, and 1996

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ISSUES

I. **Add Back of State Taxes Based On Or Measured by Income**: Michigan Single Business Tax.

Authority: IC 6-5.5-1-2(a)(1)(C); First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999); 45 IAC 17-3-1(3).

Taxpayer protests the auditor's determination that the Michigan Single Business Tax is a tax sufficiently based on and measured by income such that the tax must be added back for purposes of determining taxpayer's liability under Indiana's Financial Institutions Tax. Taxpayer argues that the tax does not meet the definition of a tax based on or measured by income and therefore, no addback of the Michigan Single Business Tax is required to calculate taxpayer's adjusted gross income.

II. **Determining Bad Debt Addback**.

Authority: 26 U.S.C.S. § 63; 26 U.S.C.S. § 166; Montgomery v. State Bd. Of Tax Comm'rs, 708 N.E.2d 936, 939 (Ind. Tax Ct. 1999); Fort Wayne Nat'l Corp. v. Indiana Dept. of State Revenue, 621 N.E.2d 688, 671 (Ind. Tax Ct. 1993); IC 6-5.5-1-2(a)(1)(A); IC 6-5.5-1-2(a)(2)(C).

Taxpayer protests the auditor's determination that taxpayer, in calculating the Financial Institutions Tax, understated the amount of the bad debt addback. Taxpayer maintains that in determining the amount of bad debt addback, it should be allowed to net the amount of bad debt against any amount of that bad debt recovered during the tax year.

Statement of Facts

The taxpayer is a bank holding company with a number of subsidiaries located in Michigan, Illinois, and Indiana. The taxpayer is currently headquartered in Ohio. During the period in which the audit was conducted, taxpayer owned two Indiana banking subsidiaries which were later merged.

DISCUSSION

I. **Addback of State Taxes Based On Or Measured by Income**: Michigan Single Business Tax.

In calculating the taxpayer's adjusted gross income under the Financial Institutions Tax, the starting point is "taxable income" as defined in 26 U.S.C.S. § 593. IC 6-5.5-1-2(a). Under IC 6-5.5-1-2(a)(1)(C), a taxpayer is required to add back to "taxable income" an amount equal to a deduction allowed or allowable under I.R.C. § 63. (*See also* IAC 17-3-1(3)). Specifically, the regulation calls for the addback "for taxes based on or measured by income and levied at the state level by a state of the United States . . . ." IC 6-5.5-1-2(a)(1)(C). The auditor determined that the amount of taxes taxpayer paid pursuant to the Michigan Single Business Tax was "sufficiently based on and measured by income" (Ind. Dept. of Revenue Explanation of Adjustments, p. 7) such the taxpayer was required to add back those taxes in arriving at Indiana adjusted gross income. The taxpayer disagreed arguing that the Michigan Single Business Tax did not meet the definition of a tax based on or measured by income.

In First Chicago NBD Corp. v. Dept. of State Revenue, 708 N.E.2d 631 (Ind. Tax Ct. 1999), the court held that the Michigan Single Business Tax was a value added tax which used taxable income as one component in its base calculation. Id. at 633-34. However, because of the extensive adjustments which were made to the individual taxpayer's taxable income in arriving at the Michigan Single Business Tax, the tax "becomes an entirely different tax, one that cannot be fairly read to fit under the 'based on or measured by income' language chosen by the Indiana General Assembly." Id. at 635.

FINDING

Taxpayer's protest is sustained.

DISCUSSION

II. **Determining Bad Debt Addback**.

The taxpayer protests the means by which the auditor determined the amount of bad debt added back in calculating taxpayer's adjusted gross income under the Financial Institutions Tax.

IC 6-5.5-1-2(a) states that, in determining a financial institution's adjusted gross income, the starting point is "taxable income" as defined by I.R.C. § 63. (26 U.S.C.S. § 63). To that amount of taxable income a number of adjustments, peculiar to Indiana, are then made. In particular, the taxpayer is concerned with the application of two of these adjustments – one of which is an "addback" while the other is a subtraction provision. The first adjustment, relevant here, is the addback provision found at IC 6-5.5-1-2(a)(1)(A) which states that the taxpayer must add "[a]n amount equal to a deduction allowed or allowable under Section 166, Section 585, or Section 593 of the Internal Revenue Code." Id. Therefore, if the taxpayer was permitted to deduct a bad debt loss to calculate its federal tax, Indiana requires the bad debt loss be added back in order to determine the Indiana adjusted gross income.

The second adjustment is found at IC 6-5.5-1-2(a)(2)(C) which states, in relevant part, that the taxpayer is required to subtract "[a]n amount equal to a debt or part of a debt that becomes worthless, as permitted under Section 166(a) of the Internal Revenue Code."

The calculation of the addback amount, under IC 6-5.5-1-2(a)(1)(A), is the point at which the Department and the taxpayer part ways. The auditor determined that the amount of addback should be equal to the amount previously deducted on the taxpayer's federal returns for bad debt loss. The taxpayer disagrees and states that the amount of addback should be the *net* of the bad debt loss together with any amount recovered on those bad debts.

Taxpayer maintains that its method of netting bad debt and bad debt recovery is consistent with Treasury Regulations. For example, taxpayer cites Treasury Regulation 1.469-2T(b)(1) for the proposition that income and loss items are to be netted in order to derive the passive activity loss deduction. The taxpayer further argues that the Department's own application of the bad debt statute, adding and then subtracting the same amount, produces an absurd and illogical result because the Department's interpretation of the statute results in a zero tax affect. According to taxpayer, applying the rules of statutory construction, taxpayer's method becomes meaningful because the amount of addback and the corresponding amount subtracted does not simply reverse itself because the two amounts, assuming some amount of bad debt recovery, are necessarily different.

The taxpayer is correct in its assertion that the issue is one of statutory interpretation. In arriving at an interpretation of the statute the tax court has instructed that "[t]he cardinal rule of statutory interpretation is to ascertain and give effect to the intent of the legislature [with] all other rules of statutory interpretation . . . subservient to that cardinal rule." Montgomery v. State Bd. Of Tax Comm'rs, 708 N.E.2d 936, 939 (Ind. Tax Ct. 1999). In giving affect to the intent of the legislature and meaning of any statute the Indiana Tax Court has further stated "when construing a statute, the court is to give statutory words and phrases their plain ordinary, and usual meaning . . . ." Fort Wayne Nat'l Corp. v. Indiana Dept. of State Revenue, 621 N.E.2d 688, 671 (Ind. Tax Ct. 1993).

IC 6-5.5-1-2(a)(1)(A), the relevant addback provision, provides that the taxpayer is required to add back to the amount of federal taxable income, "[a]n amount equal to a deduction allowed or allowable under Section 166, Section 585, or Section 593 of the Internal Revenue Code." Id. Because Section 585 and Section 593 are not applicable, the taxpayer must look to Section 166 (26 U.S.C.S. § 166) to determine the amount of the required addback.

Section 166 of the Internal Revenue Code provides in relevant part that as a "General Rule (1) Wholly worthless debts. There shall be allowed as a *deduction* any debt which becomes worthless within the taxable year. (2) Partially worthless debts. When satisfied that a debt is recoverable only in part, the Secretary may allow such debt, in an amount not in excess of the part charged off within the taxable year as a *deduction*." 26 U.S.C.S. § 166 (Emphasis added). By reading together 26 U.S.C.S. § 166 and IC 6-5.5-1-2(a)(1)(A), the meaning of the latter provision becomes apparent. Any deduction taken pursuant to 26 U.S.C.S. § 166 must be added back to the federal taxable income calculation in order to arrive at adjusted gross income for the purpose of determining Indiana's Financial Institutions Tax. IC 6-5.5-1-2(a)(1)(A) simply does not reference any procedure by which the taxpayer may apply a *reduction* to the *deduction* authorized under 26 U.S.C.S. § 166. This straightforward interpretation and application of the IC 6-5.5-1-2(a)(1)(A) accords with the Tax Court's admonition that we are "to give statutory words and phrases their plain ordinary, and usual meaning . . . ." Fort Wayne Nat'l Corp. 621 N.E.2d at 671.

FINDING

Taxpayer's protest is respectfully denied.